ENERGY INFRASTRUCTURE PLANNING:

How to Spend Proceeds from Iraqi Petroleum Production

DECISION BRIEFING FOR DEPUTIES

Dated: November 6, 2002
Issues to be Addressed This Month

How to organize and manage USG administration of Iraqi petroleum resources?

How to use petroleum proceeds?

What to do about current sanctions against Iraq?

Should Iraqi oil production capacity be developed, or merely operate what already exists?

Should production capacity be developed, what to do about existing and new development contracts?

Whether to use control of Iraqi oil to advance important US foreign policy objectives affected by energy issues?

declaratory policy?

11/6/02 5:40 PM
Prepared by Energy Infrastructure Planning Group
(b)(2)
Derived from Multiple Sources
DECL ON: 6 Nov 2012
Assumptions

Existing UN Security Council economic sanctions against Iraq no longer apply and have been modified to permit U.S.-led administration of petroleum proceeds.

- The UN Iraq escrow account.
  - Will not be available for use by US-led administration of Iraq.
  - Will continue to have virtually no reserve funds.

Proceeds from petroleum proceeds will be insufficient to pay for all needs of Iraq for several years to come.

B: Interagency legal review underway on sanctions regime, Hague regulations and other matters that may affect assumptions and decisions on use of proceeds.
Unknowns

The level of aid other countries will be willing to provide to post-Saddam Iraq.

- Condition of Iraqi energy infrastructure.
- Fluctuations of world oil supply and price.
- Paris Club decisions on rescheduling Iraqi debt.
- Willingness of Gulf War claimants to forgo claims.
Revenue Amount

Petroleum revenue will vary according to levels of production and price. Total revenue, including export revenue, could exceed $20 billion per year. If Iraq produced its approximate current capacity of 3 million barrels/day, and oil price fluctuated within a $18-28 per barrel range, it would reap $20-31 billion in annual revenue, excluding cost of production.

If domestic Iraqi consumption remained constant at current level, 300 thousand barrels/day, annual export revenue would range from $18 to $28 billion. In principle, as Iraqi economy recovers, its production should rise.

Resolution: it took Kuwait two years after the Gulf War to regain prewar production.

Total: $20-31 billion per a
Option: Pay For Humanitarian Aid

The level of aid required is unknown and difficult to estimate in advance. Requirements will depend on numerous variables.

- Extent of war damage.
- Disruption of electricity, fuel, water and food supplies/distribution systems.
- Displacement of population.

Could be an immediately available source of funding for urgent needs, if petroleum production not seriously disrupted.

Would reduce dependence on international assistance, which is time-consuming and difficult to assemble.

Would reduce aid costs borne by US.

Could reduce incentives for other countries to provide aid.

Would divert resources from other important uses.
Option: Post-Conflict Reconstruction of National Infrastructure

The level of damage resulting from military campaign cannot be precisely estimated in advance.

- Degree of resistance.
- Incidence of sabotage.

A estimates of need range widely.

- $28-40 billion over ten years ($3-4 billion annually) if war damage comparable to Gulf War.
- Damage could be much higher than in Gulf War.

Total: $3-4 billion per annum
Option: Post-Conflict Reconstruction of National Infrastructure (cont.)

- Could be immediately available source of funding.
- Would reduce dependence on international assistance.
- Would reduce needs for US funds and avoid implication that USG is legally responsible.
- Could accelerate process of Iraqi independence and political stability.

Diverts resources from other uses.
Arguably should be decided by new Iraqi government.
Option: Repair Existing Energy Infrastructure

Includes petroleum production, refining, pipeline, electricity and natural gas facilities.

Wars and sanctions have eroded condition of energy infrastructure.

Iraqis have used band-aids and questionable industry practices to keep oil flowing without damaging the oil fields.

Possible decline in production capacity of roughly 5-15% annually, and even more in the north, if current conditions persist.

Iraqi cost of production per barrel is less than one-half of other producing countries in the region, suggesting improper production techniques.

It will take pre-Gulf War production of 3.5 million barrels/day, with no new dams, to reach 3.5 million barrels/day with war damage, costs could exceed $5 billion over 12-18 months.

Includes well workovers, and maintaining and fully utilizing existing facilities. Might require expansion beyond existing facilities.

Kuwait spent $5 billion in first 12-18 months to repair damage caused by theft and sabotage in Gulf War, and perhaps $20 billion overall.
Option: Repair Energy Infrastructure (cont.)

Essential for maintaining revenue stream and even partly meeting demand for funds outlined in this briefing.

Would minimize reliance on international assistance.

Would facilitate any decision, by US-led administration or new Iraqi government, to increase production capacity.

Could be controversial, sparking allegation of US exploitation.

Would divert resources from other uses.

Could discourage private sector involvement.

Could prejudge policy decision on increasing production.

Total: $2-5 billion per a
Option: Pay Foreign Debt

Iraq has made no foreign debt payments since 1990.

UN sanctions regime has shielded oil reserves from claims by those holding Iraqi dollar-denominated foreign debt estimated to be over $82 billion, including interest from 1990.

Principal owed is $41 billion.

Excludes $37 billion in principal owed to Gulf states from Iran-Iraq war.

Largest governmental creditors—Russia and France.

Russia is owed $16.1 billion (principal: $8 billion), or 20% of total—mostly for weapons.

France is owed $9.1 billion (principal: $4.5 billion), or 11% of debt.

Japan is owed $9.1 billion (principal: $4.8 billion), or 11%.

US is 6th largest creditor: owed $4.4 billion (principal: $2.2 billion), or 5%, less than Germany and former Yugoslavia.

Annual debt service estimated at $7-15 billion.

So far no bilateral or multilateral debt rescheduling.

Total: $7-15 billion per annum.
Option: Pay Foreign Debt (cont.)

New investment often not precluded by non-payment of previous regime’s debt.

Not unusual to give new regime grace period of several years.

Cuba never repaid its pre-Castro debt or compensated investors for expropriated property, and yet investors came in. Soviet Union was lent money even though it paid a tiny fraction of tsarist debt.

Debt servicing may be necessary to promote investment, trade and economic recovery.

Could strengthen international support for US policies.

We have generally not distinguished debt for military sales from other types of debt.

Not an urgent priority, unless necessary for near-term foreign investment.

Paris Club negotiations necessary, and appropriate for new Iraqi government to participate on matter that will have such long-standing consequences.

US should not be perceived as adding to new government’s burdens.

Paying for Russian arms sales to Saddam should not be a priority.

Diverts resources from other needs.
**Option: Pay Gulf War Compensation**

Since 1991, UN Compensation Commission has received 2.6 million claims from host 100 countries totaling over $300 billion, for compensation for losses resulting from Iraq’s invasion and occupation of Kuwait.

By October 2002, UN Compensation Commission has approved $43 billion in claims, of which $16 billion has been paid.

UN deducts 25% annually of Iraq’s oil revenues for compensation. 7 billion left to be paid on claims already validated and awarded.

Over $15 billion alone to Kuwaiti Oil Company.

$457 million to US corporations.

70 billion in claims remain to be considered.

$149 billion worth of claims from governments, over half of which are from Kuwait.

Other large claimants: Jordan and Saudi Arabia.

$5.2 billion in corporate claims, including 119 U.S.-filed claims seeking $213 million.

$8.5 billion in individual claims.
Option: Pay Gulf War Compensation (cont.)

OFF does not apply, a new structure would need to be established to pay claims. NSCR 687 imposes liability on Iraq for these claims independently of OFF program.

25% payout for compensation could exceed $5 billion in annual payments.

- Could promote international support for US policies.
- Could avoid renegotiation of UNSCR 687.
- Preserves an important precedent in using Security Council action to deter future aggression by ensuring aggressor sacrifices financially to compensate its victims.

Would burden new Iraqi government with precedent of paying for substantial war caused by Saddam regime.

Many American groups and businesses already feel the process is opaque and unfair. Could be preferable to establish a conference of claimants, where we would encourage forgiveness of claims, particularly by Kuwait, which would have an interest in generosity.

Total: $5-7 billion per annum
Recover US/Allied Costs of Occupation

Three aspects

US/allied military—salaries, operations and maintenance, etc.
- Most controversial.

US/allied civilian—American civilians involved in administration.
- Very few people involved.

Iraqi administrative—salaries for Iraqis in government bureaucracy, utilities, etc.
- Uncontroversial.
- Costs partly met by collection of taxes from Iraqis.

BO estimates cost at $4 billion per month, excluding costs for humanitarian aid and reconstruction of Iraq.

Transparency in accounting particularly necessary here.
Recover US/Allied Costs of Occupation (cont.)

- Occupation benefits Iraqi people and should be paid by Iraqi resources. Probably permissible under any applicable legal theory (legal review still ongoing).

- Would be highly controversial internationally.
- Could generate domestic Iraqi opposition.
- Would reduce resources available for other urgent needs.
- Even if all revenues devoted to this category, it would only cover about half of projected monthly costs.
- Would deviate from UNSC decisions to exclude costs of military operations from Gulf War compensation obligations.
Recover US/Allied Costs of Military Campaign

Estimated costs of campaign vary.
- CBO estimates $20 billion for deploying troops to Gulf and returning troops home, $6-9 billion in combat expense per month.
- House Budget Committee, Democratic staff, estimates up to $60 billion total.

Gulf War of 1991 cost $58 billion.

Potential legal distinction between operations inside and outside Iraq (subject of ongoing legal review).
- Operations inside Iraq: legally permissible.
- Operation outside Iraq: legally controversial.

Transparency in accounting also essential here.

Total: $30-60 billion per a
Iraqi resources should pay for campaign that liberated Iraqi people and removed international threat emanating from the country.

Would be very controversial. Could erode international support for US policies, and could affect support for future interventions. Would divert resources from other needs.
Summary / Balance Sheet

Demands on petroleum revenue will substantially exceed available funds for the foreseeable future.

Numbers below exclude potentially large humanitarian needs, unaddressed Gulf War claims, and potential repairs to petroleum infrastructure beyond 12-18 months after conflict. When possible, (average) annual numbers are provided.

<table>
<thead>
<tr>
<th>RANGE OF FINANCIAL DEMANDS (in $ billions)</th>
<th>Low</th>
<th>High</th>
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<tr>
<td>Humanitarian Aid</td>
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<td>Reconstruction of War-Damaged Eco. (annual avg)</td>
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<td>Repair Energy Infrastructure (initial)</td>
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<td>Foreign Debt Payment (annual)</td>
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<tr>
<td>Gulf War Claims (annual)</td>
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<td>7</td>
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<td>Costs of Occupation (annual)</td>
<td>48</td>
<td>48</td>
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<td>Costs of Military Campaign (total)</td>
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<td>60</td>
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<td><strong>TOTAL DEMAND</strong></td>
<td><strong>95</strong></td>
<td><strong>139</strong></td>
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| TOTAL PETROLEUM PRODUCTION REVENUE | 20 | 31 |
| BALANCE                            | -75 | -108 |